RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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June 3, 1977 **LETTER 699**

May 20, DJIA 930.46; PTI 859; A-D Ratio −19.15
May 27, DJIA 898.83; PTI 833; A-D Ratio −20.51

THE PICTURE: It's always hard to write bearishly about the market. Most investors don't want to hear it, new readers usually don't believe it (unless the market is literally falling apart), and older subscribers probably know as much about it as I do. But I'm not running a popularity poll here, nor am I running a "Happy Times Herald" for those who want to stay perpetually optimistic. My job is to get to reality, to try to make sense out of the story that the stock market is telling us.

Now the market is never "normal" and the market is seldom easy. The day we have an easy, normal, well-behaved market is the day I'll probably quit the business in a state of shock. But the 1976-77 market has been a SOB, a killer, a tough devil. I've sensed that the **story was in the D-J Industrial Average**, and I've sensed that the Dow (specifically the Dow) was on to "something big." I still don't know the fundamentals behind the dreadful 1977 performance of the Dow, but I know one thing–if the rest of the market can't pull the Dow up, then the Dow will drag the rest of the market down. And that seems to be just about what is happening here in June, 1977.

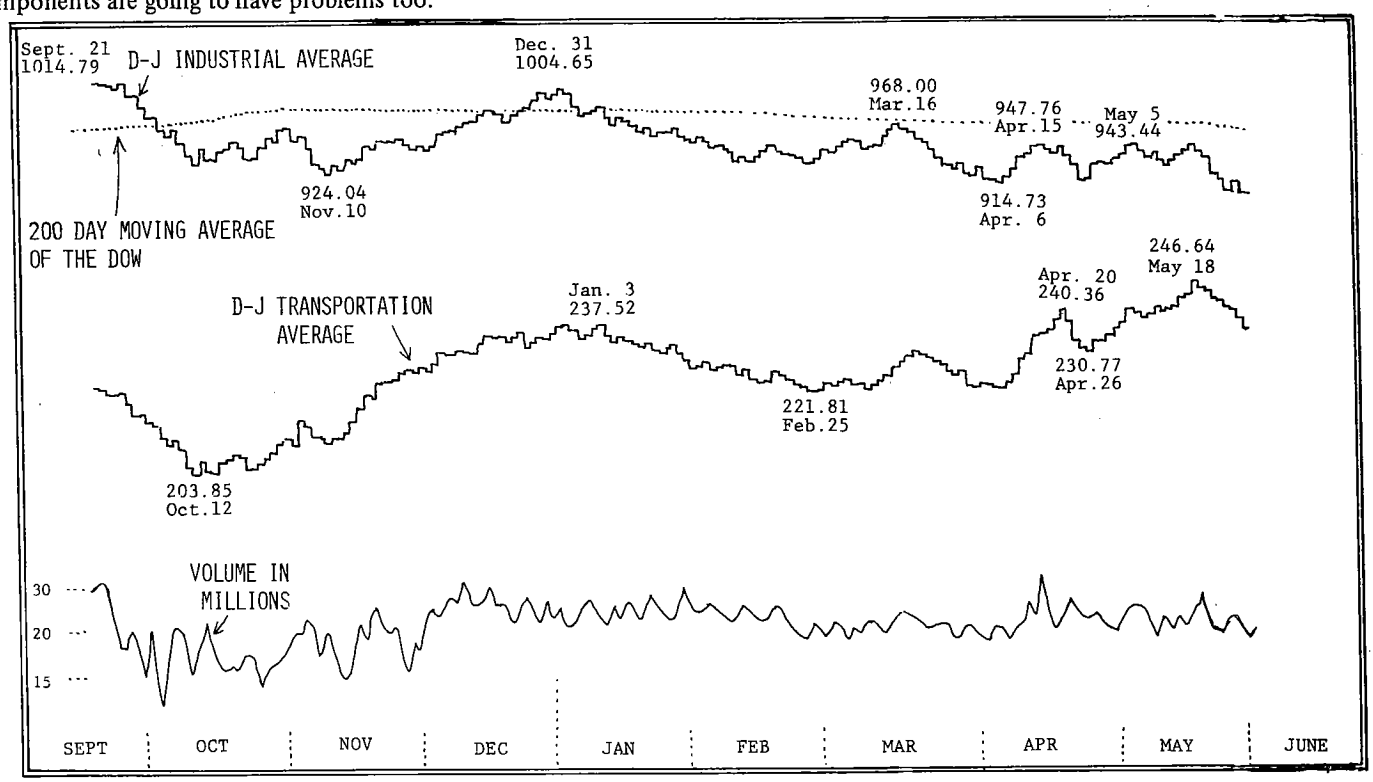
We've been hearing for months that "the Dow isn't the market," and that "the secondary stocks are doing fine without the Dow, thank you." I've tried to cut through that fantasy, and I've told readers that anything powerful enough to bring the Dow to its knees is important enough to affect every other segment of the nation. If General Motors and Eastman Kodak are having problems, then sure as hell all the dozens of companies that make sheet steel and imitation leather and photo chemicals and camera components are going to have problems too.

Question: The Dow broke below 900 on Friday, May 27. What's the meaning of that move?
Answer: I feel it's an event that is basically *psychological*. All year long we've been hearing that the Dow is going to "fluctuate between 900 and 1150." Suddenly investors see the Dow in the 800's. It's an event that's bound to stir up fear and consternation.

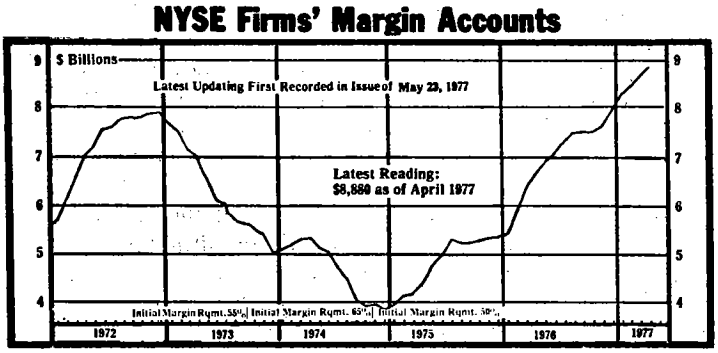
Question: Russell, you've made a lot of the strength in the Transport and Utility Averages. What about them now?
Answer: The most **determined trend** in the Averages sets the ultimate course for the whole market. Strong as the Transports (and Utilities) have been, the Industrial weakness seems to be the winner. I feel that the Transports about exhausted themselves on the upside, as did the Utilities. But the Industrial Average seems to grow more vigorous on the **downside**. The other Averages and the general market now seem to be falling in line with the weak Industrials.

This is what I was afraid would happen, and this is the reason I said in all Letters since Letter 694 (April 13) that we should "sell to the comfort point," cut down on common stock holdings, even get totally on the sidelines.

Question: Do you think we are going into a primary bear market, Russell?
Answer: Personally, I don't. I think we are in a secondary reaction, and that it has the potential of being a severe one. By that I mean a secondary that I would **not** want my subscribers to "ride out."



Question: What bothers you particularly about this market at this time? **Answer**: Aside from Industrials, a number of items. First, I include this chart from *M/G Financial*, showing **NYSE margin debt.** The latest figures show margin debt to be $8.8 billion, *highest level in history.* Now the stock market has an uncomfortable habit of behaving like a "bad boy in a newly decorated living room" If you know boys, you know that if anything can be messed up, torn up, spilled or broken, just count on that little fellow to do it. And count on the stock market to do the same!



Right now, I see that enormous, record-breaking $8.8 billion of margin as a kind of "sitting duck." And I'm afraid that the stock market is going to try to touch that margin off, just as if it was a giant stop-loss order. If the stock market does start to set off margin calls, then it's not going to be a pretty sight. And we're going to see some rather frightening downside action.

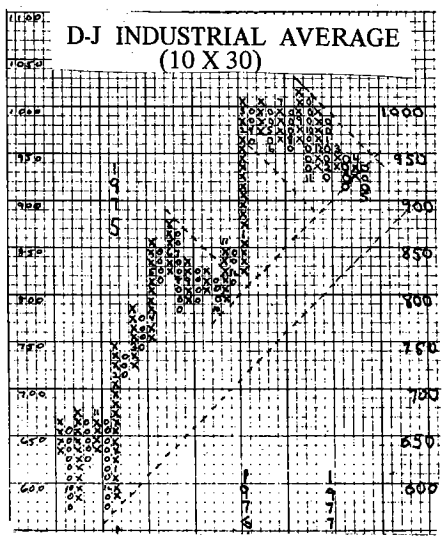
That's one thing that bothers me. There are a few other items that bother me, and they show up on the point and figure charts. Often a P&F chart will bring out something that you will not see or understand anyplace else. At any rate, I have been watching the P&F charts put out by my friends at *Chartcraft* (Larchmont, NY 10538), and they worry me. I am including two of those charts here. The first is a very compressed picture of the Dow, each box equalling 10 points with only 30 point changes shown (X's denote rallies of 30 points or more, O's denote declines of 30 points or more).

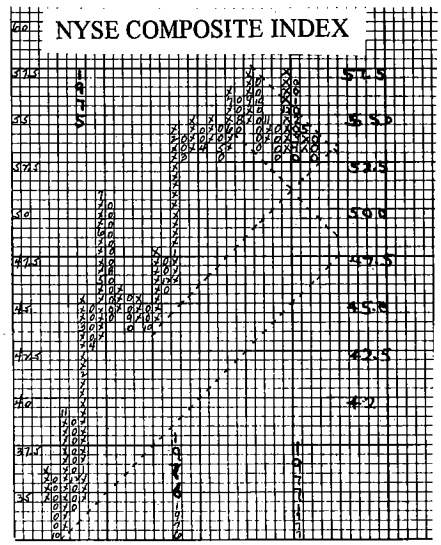
Well, you don't have to be an expert to see the damage being suffered by the **Dow.** The latest decline (vertical row of O's) breaks one rising trendline and shatters the whole Dow formation since 1976. It's a powerful looking downside break, and I don't like it.

But the P&F chart of the **NYSE Composite** is even more significant. This chart shows an amazingly symmetrical, toppy formation in the Composite. Furthermore, we see five bottoms at the 53.00 level. Any close at 52.50 would shatter the whole toppy structure in the NYSE Composite and, I feel, point to generally lower prices across the board. Remember, the NYSE Composite includes all Big Board common stocks. As this is written, the Composite is within a tiny fraction of 52.50.

Question: Beautiful, Russell, I see there's plenty to worry about, and you've already spoiled my Memorial weekend. But in view of what you've said, should I sell the Transport and Utility stocks as well? **Answer**: The history of the Transports and Utilities shows that they often move in a greater percentage swing than the Dow. If the Dow and the general market go into a severe secondary now, it is possible that the Transports and Utilities (and many secondary stocks) will make up (on the downside) for lost time. I don't really know, nor does anyone else. But in the light of past performances, I would be very careful about carrying Transports and Utilities through this decline. You can always buy stocks back, but you can't always get your money back. Once you've lost hard, after-tax capital, it's gone, and you may spend years recouping those losses. I've been stressing that fact for the past year.

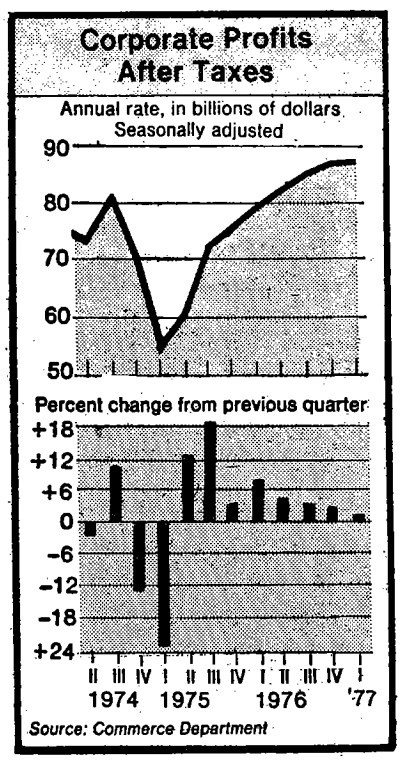
Question: In view of all the rosy economic forecasts for 1977 and beyond, what do you think's got into this market, Russell? Has it lost its marbles or something? **Answer**: Ah, the "Why?" question. Your answer may be as good as mine, but one little chart (from the *New York Times*) may have escaped the attentions of the average economist. I think it is telling a vital and little-known story.





The chart shows the percentage change of corporate profits from the preceding quarter (lower part of chart). Did you know that the percentage change has now dropped five quarters in a row? Well, I'm sure the market hasn't missed this little fact, and that could be the problem. And I'd say it's one of those problems that's so fundamental, so obvious, that it's easily missed. At any rate, I present it as a thought.

Question: What if your so-called correction turns out to be a bear market,

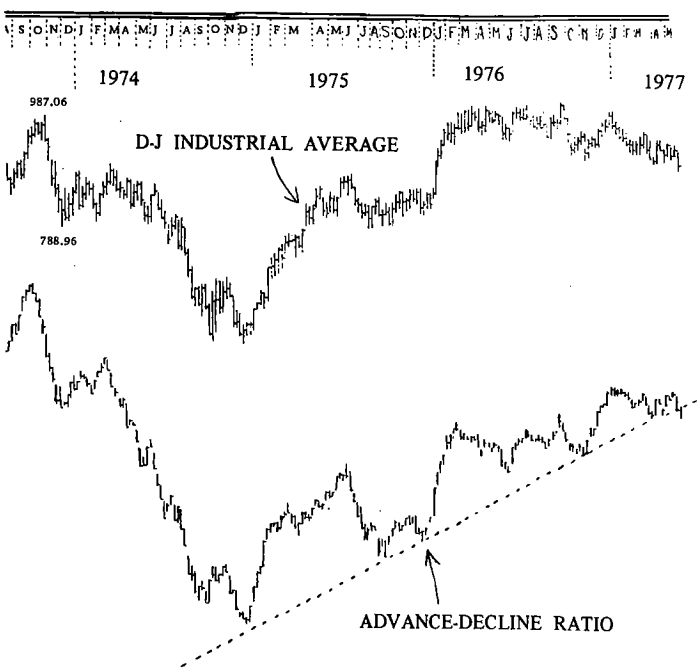


Russell? Then what do we do? **Answer**: Again, I'll say that I don't think we're in a bear market. And I certainly hope (for the sake of the nation) that it's not a primary bear market. But since my subscribers are now pretty much on the sidelines, we're tactically in the **same position** as we would be if this were a primary bear market. So from an investment standpoint, this can be another 1929-32 or another 1973-74 and we're positioned correctly. But again, I'll say that the long-term and fundamental implications of a correction, even a severe correction, is far different than would be the case if this was a primary bear market.

Question: While we're at it, Russell, are there any other technical comments you want to throw in here? **Answer:** A few; for one, I noted in this week's *Barron's* that 16 stock **groups** broke to new lows for the year. That is the largest number of new group lows in a single week since December, 1974. The statistic indicates increasing downside momentum.

Speaking of downside momentum, my 34-week rate of change chart for the Dow dropped last week to 89%, meaning that the Dow is now 89% of its price 34 weeks ago. That's a new low for this entire bull market, and it shows that the Dow is increasing its *rate of descent*.

Finally, the *NYSE member trading* has been running heavily on the sell side. This is quite rare, and I wonder where the members get all the stock that they are selling. They are sure moving those shares out. Since 1976 Exchange members have sold almost 70 million shares (70 more than they have purchased), with 29 million of that amount having been dumped in 1977. The members act as if the market is going to zero. Now the members may not all be geniuses, but they wouldn't be members if they were broke. So all that selling bothers me, particularly in view of my other studies.



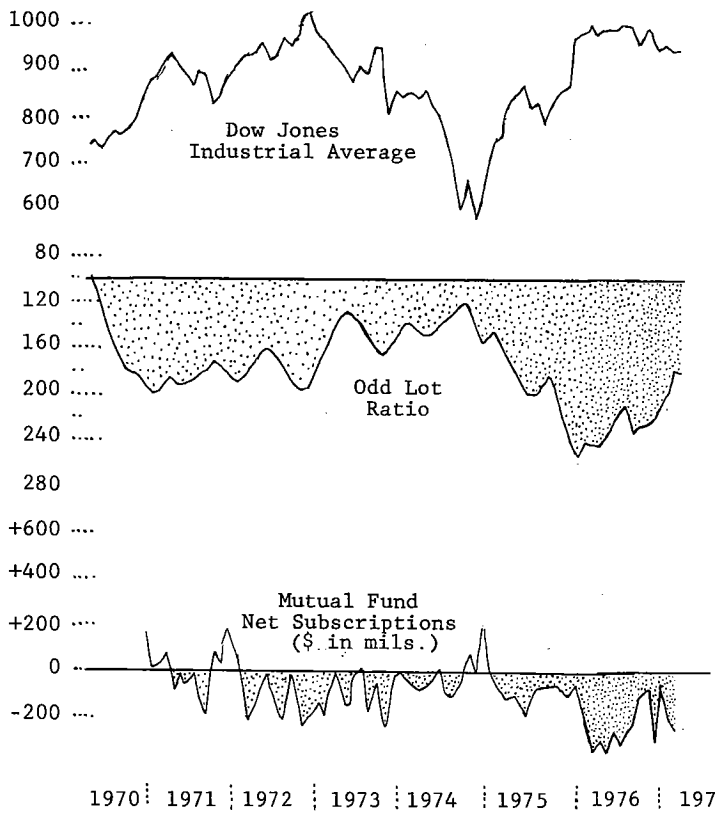
Question: What about the advance-decline line now? It's been strong all year. Isn't this an "island of hope" for us? **Answer**: Unfortunately, I'm going to say NO to this one. To see why you have to study my *weekly A-D chart* (weekly highs and lows based on daily figures). The A-D ratio moved up in five, definite waves to a peak on January 3, 1977. Last week the A-D **cracked the entire rising trendline which started at the 1974 low**. Thus, the very real possibility now exists that we will now get a full correction in the breadth of the market. This is all the more interesting in view of the chorus of investors who are saying, "The Dow and the glamors may be going, but they haven't touched my high-yielding little secondary issues yet." What I'm afraid of is that the A-D reversal (to the downside) is implying that the **whole market**, from A to Z, will be in on this correction. If so, my "light or on the sidelines" advice will be doubly warranted.

WHO IS BUYING AND SELLING? In the last Letter I discussed the three phases of a bull market. I expressed the opinion that the second (psychological) phase of this primary bull market began in late-1975 and that we are still in the second phase.

One of the criteria I use to judge bull market phases is the buying or selling proclivities of the *public*. We know that the public is scared and highly skeptical during the first phase of a bull market. And we know that the public usually stays well away from the stock market during the second phase of a bull market. It is only during the third or final (distributive) phase of a bull market that the public rushes headlong into Wall Street.

Two of the items I watch as gauges of public sentiment (and action) are shown on the accompanying chart. The top line is simply the monthly closing for the D-J Industrial Average. The second line is a three month average of monthly *odd lot* statistics. The ratio shown is arrived at by dividing odd lot sales by odd lot purchases. A figure of 100 means that purchases and sales are equal. A figure of 200 means that there are 200 shares sold for every 100 bought.

On a long term (monthly figures) basis, the odd lot public turned extremely bearish on the market during 1970, and since then the



three-month average of the buy-sell ratio has remained steadfastly on the sell side. Note that during late-1974 and through 1975 the odd lotters increased their average selling steadily. By the end of the year 1975 the three month average reached the enormous sell-rate of 240. That corresponded to the first phase of the new bull market. The public could not have been more bearish during this period.

During the period of 1976 to date, the odd lot public has remained on the sell side but they have been decreasing their selling. This, I feel, is typical of second phase action during a bull market. The public pulls in its bearishness somewhat, but skepticism is still king. When we get the eventual third phase of this bull market I would expect the odd lot public to swing over to the buy side as the odd lot ratios drop below 100. They have not done this in seven years.

At the bottom of the page we see almost the same story via the figures on *net mutual fund subscriptions*. These figures represent purchases of mutual funds minus redemptions, and they are adjusted so that liquid assets and bond funds are not included in the figures. Note that 1971 saw the first net redemptions over purchases for mutual funds. This has continued steadily throughout the bear market (which ended in late-1974).

Then during 1975 and 1976, as the new bull market got underway, the mutual fund public stepped up its selling, and this action has continued to date. Again, I believe that when the third phase of the bull market gets underway, the mutual fund industry will be amazed (and delighted) to see the public once again pour into funds, thereby pushing purchases well above redemptions. All of which seems pretty farfetched now, but I think we will see it materialize within two or three years.

DOW STOCKS: The last Letter analyzed the technical position of the first 15 Dow stocks, and I want to cover the other 15 now. Obviously, this study is not "The Answer" to what's going to happen on Wall Street, but I find that dissecting the Dow can give you a feel for the market that is very helpful.

Int'l Nickel has been riding down the underside of a major declining trendline ever since 1970. Nevertheless, as you can see on the chart the stock has been in an uptrend since 1974. But now the situation is in doubt. A triangle has formed, and I feel a break to 22 would mean "top out" for Nickel.

Int'l Harvester is "blowing off" on its fifth wave, and this should complete the move up for the time being. Of course, a fifth wave can sub-divide into five more waves, but I don't think that will happen. HR has an exhausted look.

Int'l Paper appears to have formed a "head-and-shoulders" top. The technical support at 53 has been penetrated. This is a stock to be avoided.

Johns Manville has advanced in a 5-leg bull market and may have more to go on the upside. One of the better-looking Dow stocks is JM.

Minn. Mining appears very weak, having broken its trendline from the 1974 low. This is (or was) a growth stock, but of course, that's a "dirty word" on Wall Street in 1977.

Owens-Ill. will look alright, technically, as long as it can hold above 25. There's not much more I can say here.

Procter formed a huge triangle, broke weakly up above the triangle during 1976. The listless "breakout" proved to be a total failure, and PG is now spilling on the downside. Failures on the upside often prove to be successes on the downside.

Sears looks awful. A head-and-shoulders top formed, and support has now been broken. The stock has essentially gotten nowhere since its 1974 low.

Stand. of Calif. has been a winner in this bull market. Yet SD may have made its upside move for quite some time, having completed a 5-wave move. When a stock has *completed* 5 waves, it's usually a good idea to avoid it until it has fully corrected.

Texaco has been climbing lazily, very lazily, up a rising trendline. The stock appears to be a good value, but nobody's running either to buy it or sell it.

Union Carbide is a disaster. A big head-and-shoulders top has formed, and UK has plunged below support. A classic top out appears on the UK chart.

United Tech. is one of the stronger looking Dow stocks. The company is making over $5 per share, and earnings have been rising all through this bull market.

Woolworth has more than doubled from its 1974 low. But now the stock has fallen below its rising trendline, and big Z has taken the plunge. Let's face it, the retailers are just not doing well.

Westinghouse seems to have formed a real base, an ascending triangle. With probably the world's worst management, WX nevertheless appears to be solving its problems. And in truth, there have been some management changes for the better. Forget the old saying "You can be short if it's Westinghouse."

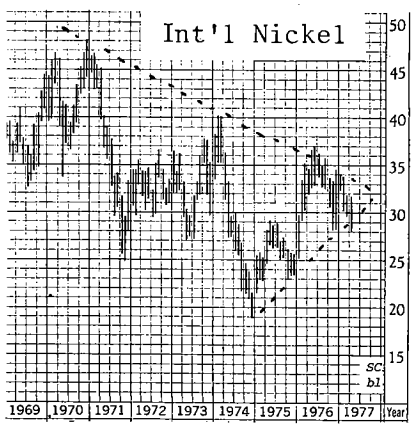
US Steel completed 5 waves up. Big Steel is now correcting, and it's a question of how strong the correction looks when it's over. In the meantime, we'll just wait on X.

Conclusion: The score is eight top outs on these 15 stocks with almost none of them looking as if they are ready to take off on the upside. If my analysis of individual Dow stocks is correct, any advancing action in the Dow is going to be selective and confined to less than half of the issues in the Dow Industrials. But the more immediate job for the Dow is to "get it over with" on the downside, to finish up the correction–then to form bases in individual stocks for the rise which some day must come.

POTENTIAL: One of the "formulas" I use in appraising mankind is this: 10% of the people are outstanding, really expert at what they do (and I don't care whether we're talking about doctors, lawyers, bricklayers or bakers). 15% of the people are smart enough to follow the expert 10%. And all the rest (the remaining 75%) vary from average down to incompetent and outright fraudulent.

But it doesn't have to be that way. I believe each of us is born with one particular **huge problem** to solve (insecurity, cruelty, disposition to be dishonest, impatience, resentment, etc.). And I believe that each of us is born with a **compensating talent.** The greater the problem we must solve, the greater the compensating talent. I firmly believe that.

I am always fascinated by men who are better than anyone else in their particular field. They are the geniuses who have really developed their particular talent. Often, these great talents are particularly conspicuous in the world of sports. For instance, I just saw the new movie, "Pumping Iron." It is the story of body building, and its hero is the amazing Arnold Schwarzenegger. Arnold has the body of a Greek god, and it is obvious that this great gift is there for a purpose. When Arnold comes on the screen, you can feel the excitement, the vibrations. You just don't look at anyone else. In one scene he appears before a group


Int'l Nickel
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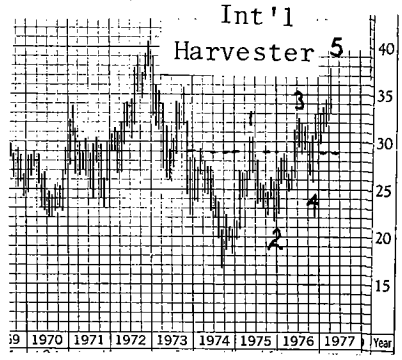
Int'l Harvester
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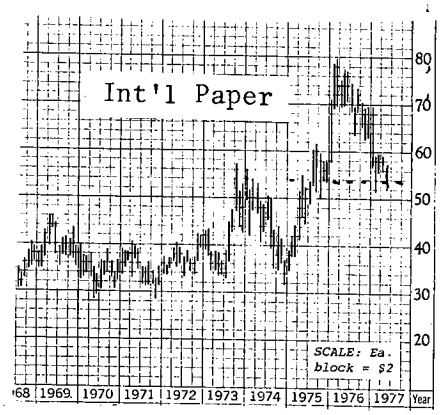
Int'l Paper
SCALE: Ea. block = $2
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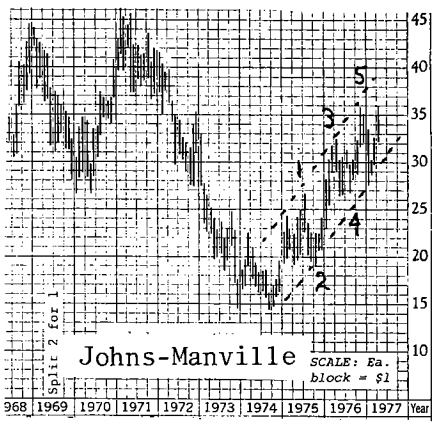
Johns-Manville
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Split 2 for 1
1 2 3 4 5
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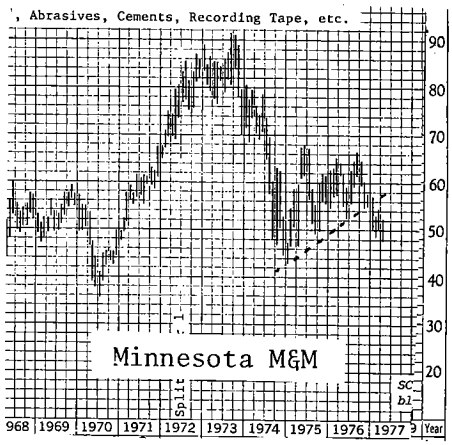
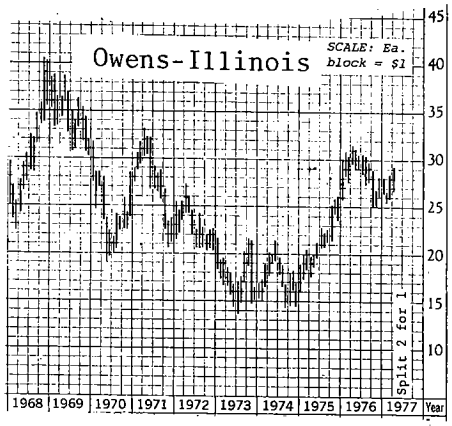

, Abrasives, Cements, Recording Tape, etc.
Minnesota M&M
Split
1968 1969 1970 1971 1972 1973 1974 1975 1976 1977 Year


Owens-Illinois
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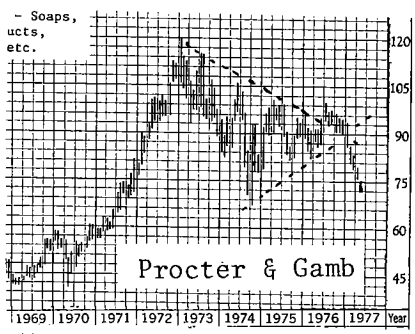
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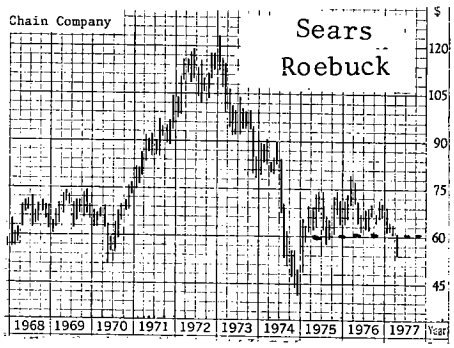
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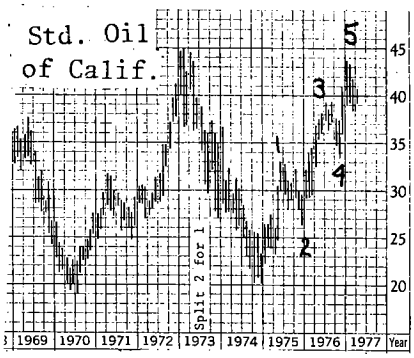
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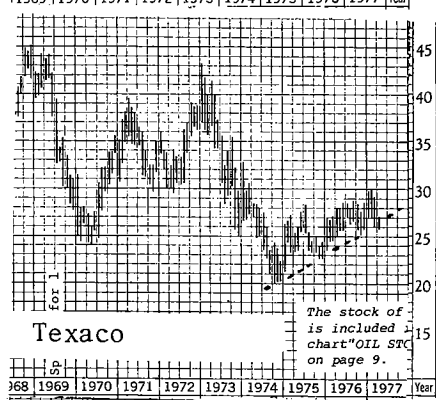
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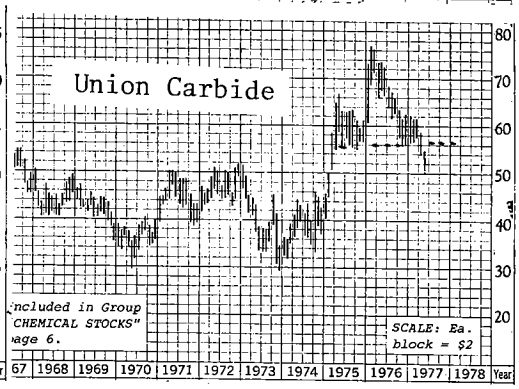
Texaco
1968 1969 1970 1971 1972 1973 1974 1975 1976 1977 Year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ncluded in Group CHEMICAL STOCKS" age 6.
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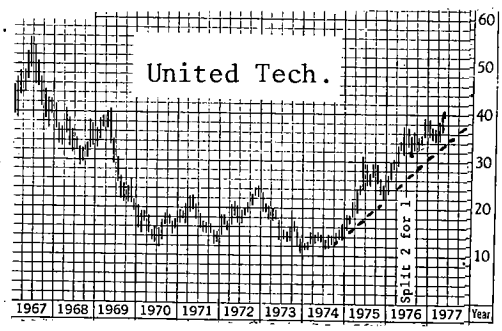
United Tech.
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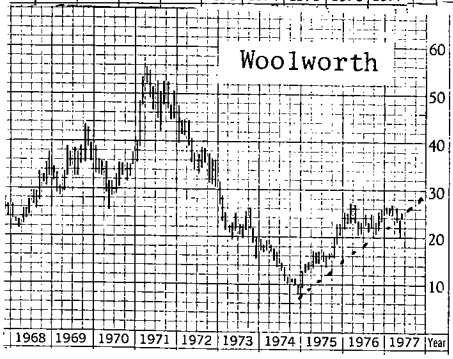
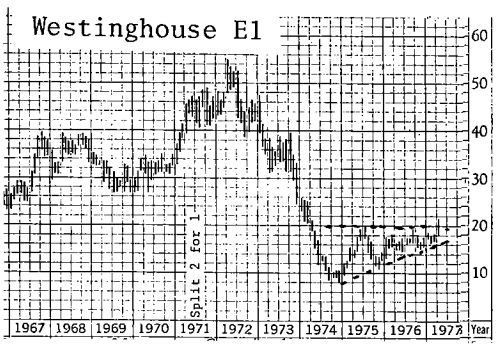

Woolworth
1968 1969 1970 1971 1972 1973 1974 1975 1976 1977 Year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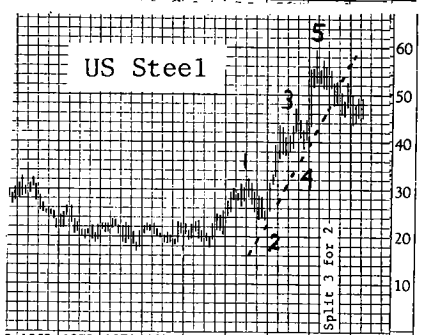
US Steel
1 2 3 4 5
Split 3 for 2
1968 1969 1970 1971 1972 1973 1974 1975 1976 1977 Year

of tough convicts in a penitentiary. He is telling them about body building and demonstrating, and they are awed.

Bruce Lee was Arnold's counterpart in the world of martial arts. Lee was the ultimate in Kung Fu and Karate. When Lee went into action, it was lightning and power, it was like nothing I've ever seen before. I never knew that a man could move that fast or with such power. Lee died at the age of 32 in Hong Kong. He must have failed at solving or even attempting to solve his great weakness. Once you are on what I call "the path," once you discover and use your great talent, then you take on a life beyond your own. And there's no turning back, no negating. If you do turn back, then like Lot's wife, you are changed to stone (symbolic of being destroyed by the powers above).

Muhammad Ali is another in the athletic genius category. He's really in a class by himself. No heavyweight in history (with the possible exception of Jack Johnson) ever moved the way Ali does. When he's serious, he towers above all other heavyweights. The only boxer I've seen that could touch Ali was welterweight genius Sugar Ray Robinson, poetry in action.

But how about you and me. Have you ever sat down and thought about your own greatest weakness–that area you must develop if you are to reach your full potential. Or have you ever thought about the possible genius side of you? Do you even perceive or experience the fact that in some area (and most people are usually too frightened to pursue this) you are an undeniable genius. I don't care whether your genius area is gardening or riding a motorcycle or playing chess or making money. It's there. Everybody possesses some extraordinary talent, if only we had the guts and persistence to uncover it.

If everyone in the world would get into his weakness and his genius, we would have a different world indeed–and a fascinating one. But people live by excuses and they live on the rot they tell themselves. They say, "I'm too old," or "It sounds ridiculous," or "I tried it ten years ago, and I got nowhere," or "I'm just too damned tired," or "I couldn't possibly get into that; my work takes up all my time."

And I say that everything else, **everything**, is secondary to your pursuit of your true ability and talent, and the ferreting out of your major weakness, the area that you must work on if you are to be a whole person.

Today we are told that there is a great energy waste and a great water waste and a great money waste. But the greatest waste of all, I maintain, is the waste of our selves. I firmly believe that if mankind, you and I, were to follow the path which leads to wholeness, all the other problems in this world would fall away like water off the back of a duck. We'd have geniuses who would discover new sources of energy, we'd harness the rains, the snows, the rivers, the sun. And we'd figure out the correct way to live instead of the mindless, dishonest, crazy path that we're now following.

Sometimes, I think that's what the stock market is telling us as it repeatedly falls away from the Dow 1000 area. Maybe it's telling us that time is running out on human stupidity, and that if we don't start moving forward, we'll fall back into the chaos of debt, dullness, arrogance and ignorance which we claim to be wrestling with. The place to **start** wrestling is with ourselves. If we don't start there, all else will fail. So I thank Arnold and Bruce and Sugar Ray and Muhammad Ali for inspiring me and others. They are all teachers by example, all of them. And I've learned a lot from each.

COMPOUNDING: Here are some items that few people realize regarding compounding bond interest rates. It applies especially to investors in IRA's and Keogh plans where taxes are deferred. Over a five year period, the interest you get on your accumulated bond interest amounts to only 17% of your total return. But over 10 years the interest you receive on the interest jumps to 33%. And over 33 years interest on accumulated interest rises to 75% of total return!

Most bond investors spend too much time fussing about current return. Over a long period of say 20 years, lower interest rates hurt a total bond portfolio return more than higher interest rates do. But since interest rates tend to fluctuate widely (particularly in these days of Fed intervention), my own feeling is that periodic fixed-sum additions to bond portfolios constitute the best strategy, as opposed to trying to outguess the swings in interest rates with in-and-out trading.

One problem with declining interest rates is that bonds are likely to be called. Thus, an advantage of long-term Government bonds is that they are non-callable (as well as being of highest quality and extremely marketable). In my opinion, every pension plan should have a certain percentage of assets in *long-term Governments* at today's high yields. For purposes of compounding interest rates, there are few better vehicles.

GOLD-SILVER: I continue to feel that the precious metals are in a corrective phase. I don't see any big movements coming up in either metal, but a "normal" correction in gold would take it down to say 130. I do not think that silver has the potential downside support that gold would have. Any movement down to $4.25 on silver would make my silver charts look rather ominous.

LATE MARKET NOTES: Having penetrated 900 on the downside, the Dow is now popping upwards, but I would be surprised if any kind of important rally got underway from here. On the recent Dow slide below its April 6 (914.73) low, neither the Transports nor the A-D Ratio confirmed. This sets up the possibility of an advance, but any rise from here would not be particularly constructive. The reason is that the market has still **not produced an important over-sold area.** The late-May lows failed by a wide margin to produce an over-sold spot on my data. Thus, any upside action from here will simply prolong the dreariness.

The hardest thing in the world to develop in this business is **patience.** The sad fact is that the majority of people tend to look for "excitement" in their investing. They want action, and I keep telling them that if they insist on action, they should go to Vegas (where it's all over in a hurry, and without commissions). But in investing, in handling money correctly, it's a matter of serious often tedious study, plodding procedure, weighing various values, taking positions that may last years. All this can be very unexciting, very uninspiring, and it all requires great patience.

People hate to be out of the market. They feel that they have to play. When they finally do get out of the market, they do it, not because it is dictated by correct procedure, but because they are "knocked out" by the market itself. At which point they swear they "will never come back." That is usually around the time that stocks are a great buy, such as 1942, 1949 or 1974. And so it goes.

RED FADE-OUT: With their ever more inter-dependent economies, whatever affects the West now affects the Communist countries. Nearly all the Communist nations had their lowest growth rates during 1975-76 in their histories. Furthermore, from a $6.3 billion debt to the West only 6 years ago, the Communist bloc debt has now grown to an estimated $40 billion. Among the worst Communist situations, Poland with a small economy and a whopping $10 billion debt, and Czechoslovakia which is now demoralized by production inefficiencies and a sliding volume of orders for its manufactured products. A straw in the wind, this year for the first time since the Cold War began to thaw, there will be no growth in US trade with the Communists.

NEXT MAILING: June 15th